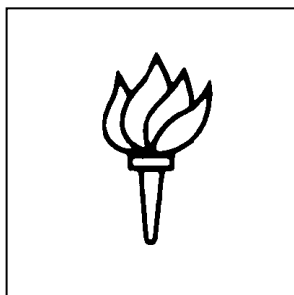


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Optimal allocation of law-making power over bankruptcy
law in “federal” and “quasi-federal” legal systems:
is there a case for harmonizing or unifying bankruptcy law
in the E.U.?

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ABSTRACT

In “federal” or “quasi-federal” legal systems, the competence over bankruptcies can be allocated either to the “federal” level” or to the “member states”. In this regard, the E.U. and the U.S. follow two different paths: while in the U.S. bankruptcy law is federalized, in the E.U. it is governed by member states. E.U. law has only unified choice-of-law and choice-of-forum criteria through a Regulation enacted in 2000, according to which, the main insolvency proceeding is governed by the jurisdiction of debtor’s “Centre of Main Interests” (“COMI”). This mechanism was meant to grant legal certainty and to avoid forum shopping, but was conceived in a ‘static’ world, where corporations could not freely transfer their headquarters into another member state and could not reincorporate abroad. This world, however, has collapsed, due to the increasing integration of the European markets and the evolution of E.U. law. European corporations now often have assets, activities and

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even headquarters in member states different from the state of incorporation and, additionally, can reincorporate from one state to another. The consequence is that, in this new environment of increasing corporate mobility, the E.U. Regulation is not able to reach its original goals. Thus, the question arises as to whether the Regulation should be amended and as to whether bankruptcy law should be harmonized or even unified at the European level. Full harmonization, on paper, has a number of advantages. Nonetheless, in the paper I argue that, at the present stage of the evolution of the E.U. institutions, it is more convenient to harmonize only few specific topics of bankruptcy law and allow transparent regulatory arbitrages and forum shopping. I suggest replacing the COMI with the registered office, as choice-of-law and choice-of-forum criterion for bankruptcies: in this way, by reincorporating in another country, corporations would transparently also choose the preferred bankruptcy law. In order to grant to member states the power to protect local interests, however, a number of rules with redistributive impact should be carved-out from general bankruptcy law and regulated by the law of the state of the COMI, regardless of the location of the registered office.

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I. INTRODUCTION

The debate upon the proper content of bankruptcy law is mainly focused on the policy goals of bankruptcy proceedings and on the desirable means to attain such goals within a specific jurisdiction. In recent years, however, due to the globalization process, the issue of cross-border insolvencies has gained relevance. Indeed, insolvent corporations can have assets and creditors in a number of different states, which may claim to be competent to govern the entire bankruptcy proceeding or, at least, to liquidate domestic assets and to protect domestic creditors. In the international arena, therefore, the question arises as to which jurisdiction should be competent to govern insolvencies and how extended its powers should be.

Similar issues also emerge within federal states, like the U.S., or within “quasi-federal” supranational entities, like the European Union, where member states enjoy great political autonomy or have sovereign powers. For the sake of simplicity, I will hereafter refer to both as “federal states” or “federal entities”.

Within these entities the issue of cross-border insolvencies can be rephrased as a question of vertical power allocation over bankruptcies. This issue emerges both within the U.S. and the European Union, despite their different constitutional characters and the different level of integration among their member states. In

this regard, the U.S. and the E.U. follow two quite opposite paths: while in the U.S. bankruptcy law has been federalized, in the E.U. insolvencies are entirely in the competence of member states and E.U. law has only unified choice-of-law and choice-of-forum criteria.

A simple explanation for this difference is that the U.S. is a truly “unified” federal state, whose Constitution explicitly allows the federal government to enact a unified bankruptcy law, while the E.U. is not a single state but an “enhanced” regional union of different sovereign states. This explanation, however, is not entirely convincing, since U.S. bankruptcy law was only federalized one century after the enactment of the U.S. Constitution, under the need to address “continental” insolvencies of big corporations (mainly railroads). In other words, the unification of bankruptcy law in the U.S. seems to have an economic rather than a constitutional rationale: the process of unification of the U.S. market and the continental dimension of U.S. firms made necessary to provide a “continental” bankruptcy law. Similarly, the European market is on its way to unification and European firms are increasingly “continental” rather than merely domestic ones. The process of integration of the European market, therefore, raises the question as to whether the European Union needs a harmonized or unified insolvency law, which would be able to address the “continental” dimension of European firms.

Indeed, despite the legal basis for such harmonization or unification being uncertain¹, the European Parliament has shown a deep interest in the question of

¹ Two alternatives are available. On the one hand, Article 50 of the Treaty on the Functioning of the European Union (hereinafter “TFUE”) allows the Parliament and the Council to enact

whether to harmonize insolvency law in Europe, by requesting Insol Europe, the association of European insolvency practitioners and scholars, to deliver a report on the feasibility of such a harmonization (hereafter, the “Insol Report”)². The report was published in April 2010 and, after a careful comparative overview of member states’ legislations, it suggests the harmonization of a significant portion of member states’ bankruptcy laws. The fundamental idea underlying the Insol Report is that the differences of insolvency rules throughout the European Union make forum shopping convenient, jeopardize transparency and legal predictability and decrease recovery chances of the insolvent firm; additionally, the Insol Report moves from the general premise that the “level playing field” is a desirable goal in itself³. These rationales lead the drafters of the report to suggest a partial harmonization of insolvency laws.

Transparency and legal predictability are desirable goals, yet it is not entirely clear whether and under which circumstances the goals to avoid forum shopping, and to attain level playing field are desirable. The present work addresses these issues and provides a general framework to understand the power allocation on insolvencies within federal states and to clarify under which circumstances

harmonization directives to attain freedom of establishment throughout the E.U. This is, among others, the legal basis for a number of directives in the field of corporate law. On the other hand, pursuant to Article 81 TFUE the Union can adopt measures of approximation of member states’ laws regarding judicial cooperation in civil matters with cross-borders implication. This second article provides to the E.U. the competence to enact directly applicable Regulations in the field of private international law, yet it can also be a legal basis for the unification of substantive law. See: Bob Wessels, *Harmonization of Insolvency Law in Europe*, EUROPEAN COMPANY LAW, 27 (No 1, 2011) and KATHARINA BOELE-WOELKI, UNIFYING AND HARMONIZING SUBSTANTIVE LAW AND THE ROLE OF CONFLICT OF LAWS, 50 -52 (The Hague, 2009).

² The report is available under:

www.europarl.europa.eu/activities/committees/studies/searchPerform.do

³ Insol Report, 26 – 27.

harmonization or unification of bankruptcy law is desirable and feasible in the European Union. In the next section, I will depict the goals of bankruptcy law: its fundamental rationale is always to address creditors' collective action problems, yet bankruptcy rules also pursue other goals and have a redistributive impact among different stakeholders involved in corporate defaults. In the third section, I will address the fundamental problems raised by international bankruptcies and the alternative policy options regarding the choice-of-law and choice-of-forum criterion and the reach of court's powers. In the fourth section, I will address the power allocation regarding bankruptcy law in federal systems and will describe the fundamental options: (i) decentralization with mandatory choice-of-law and forum criteria, (ii) decentralization with optional criteria and (iii) centralization. Under the first model, member states are competent to govern insolvencies and the competent jurisdiction is selected according to mandatory choice-of-law and forum criteria. Under the second model, such choice-of-law and forum criteria are not mandatory and corporations can opt for the preferred jurisdiction. Under centralized regimes, insolvencies are entirely or partially governed at the federal level. In the fifth section, I will compare the U.S. and the E.U. We will see that, while the U.S. follows a true centralized mechanism, where bankruptcies are governed by federal courts and by federal rules, the E.U. follows a decentralized model but has unified the choice-of-law and forum criterion (the "centre of main interests" of the debtor), so that debtors apparently do not have any option as to the competent court and law. However, in recent years the development of freedom of establishment and the increasing integration of the E.U. internal

market have changed the nature of the E.U. model, which has become more similar to an optional model. In the sixth section, I will describe the advantages and disadvantages of the three fundamental policy options (mandatory regimes, free-choice and centralization); regarding the E.U., at the present stage of its political integration, I will suggest to adopt a clear and transparent optional model and to adopt the registered office, instead of the COMI, as choice-of-law and forum criterion. However, politically sensitive redistributive rules should be carved-out from the main body of bankruptcy law and regulated by the law of the COMI.

II. GOALS OF CORPORATE BANKRUPTCY LAW

After the debtor becomes insolvent, the relations among corporate stakeholders change dramatically: shareholders and creditors shift their respective positions, so that the latter become the residual claimants of corporate activities⁴.

In order to satisfy its claim, each creditor has the right to seize the debtor's assets according to a "first come first served" basis. Creditors, however, cannot coordinate themselves and, therefore, it is rational for them to collect their debts individually and to seize a debtor's assets as soon as financial distress becomes apparent. Under an *ex ante* viewpoint, due to coordination problems this "race to grab" a debtor's assets is perfectly rational for individual creditors. Under an *ex post* viewpoint, however, the "race to grab" leads to inefficient outcomes for the creditors as a group, if the going concern value of debtor's assets is higher than the

⁴ See: Armour, Hertig & Kanda, *Transactions with creditors*, THE ANATOMY OF CORPORATE LAW, 2nd edition, 121 - 122 (Oxford, 2009)

sum of their individual market prices. In these cases, it is in the best interest of creditors in the long run to facilitate a restructuring of the corporation and to approve workout plans. In order to reach this goal, the common creditors' remedies should be displaced by other debt collection mechanisms that avoid coordination problems among creditors. The main rationale of bankruptcy law is to provide a mechanism for debt collection that aims to resolve the coordination problems among creditors and to avoid the "race to grab" a debtor's assets⁵. For this purpose, bankruptcy laws provide for a general stay of all individual creditors' claims during the bankruptcy proceeding⁶

Additionally, individual creditors may reject workout or restructuring plans, which would keep the going concern value of the firm and would be value-enhancing for the creditors as a group, simply because they hope to be paid in full if the plan succeeds and all other creditors adhered to it (s.c. "hold-out" problem)⁷. Consequently, all bankruptcy regulations and require a majority vote to approve recovery plans that also becomes binding for dissenting creditors⁸.

These two main goals related to creditors' coordination problems, namely avoiding the "race to grab" debtor's assets and the "hold-out" problems, are at the basis of any bankruptcy regulation and aim fundamentally at attaining the goal of efficient allocation of business assets. However, real bankruptcy regulations also

⁵ THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW*, 21 - 25 (Cambridge Ma, Harvard University Press, 1986).

⁶ See: JAY L. WESTBROOK, CHARLES D. BOOTH, CHRISTOPH G. PAULUS & HARRY RAJAK, *A GLOBAL VIEW OF BUSINESS INSOLVENCY SYSTEMS*, 69 – 73 (The World Bank, Washington D.C., 2010), depicting some exceptions to the general stay under different jurisdictions.

⁷ Mark J. Roe, *The Voting Prohibition in Bond Workouts*, 97 YALE L. J. 232 (1987).

⁸ WESTBROOK, BOOTH, PAULUS & RAJAK, *A GLOBAL VIEW OF BUSINESS INSOLVENCY SYSTEMS*, *supra* note 6, 156.

have “redistributive”⁹ effects, which have a much more political nature. To understand this point, we have to bear in mind that, if no workout plans are approved, debtors should pay all creditors in full and with all their assets. In case of insolvency, however, a debtor’s assets are generally not sufficient to fulfill all his or her obligations. Consequently, bankruptcy regulation can affect the redistribution of scarce resources (i.e. a debtor’s assets) among creditors¹⁰, thus making it a highly sensitive matter, both socially and politically¹¹.

Under a political viewpoint this is not without consequences. Different groups of creditors usually have different goals and views as to the proper purpose of the insolvency proceedings and will lobby the policy makers in order to pursue these interests¹². The interests of big and sophisticated creditors, such as banks and financial institutions, usually diverge from those of small lenders or non-sophisticated creditors and stakeholders, such as employees. This political relevance of bankruptcy rules is particularly evident with regard to two specific issues: pre-bankruptcy entitlements and fraudulent or preferential transfers.

a) Pre-bankruptcy entitlements. Pre-bankruptcy bargains among creditors and the corporation and pre-bankruptcy entitlements, are generally respected during the

⁹ In the paper, I use the word “redistribution” meaning that private law rules can have the virtue to allocate costs among different actors. In contrast, political scientists mostly use the same language referring to distribution of public goods by public authorities.

¹⁰ See: Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. R. 775 (1987) and John Armour, *The Law and Economics of Corporate Insolvency: An Overview*, CENTRE FOR BUSINESS RESEARCH, WORKING PAPER No 197, 8 (2001).

¹¹ Troy A. McKenzie, *Judicial Independence, Autonomy, and the Bankruptcy Courts*, 62 STAN. L. REV. 747, 774 - 775 (2010).

¹² Following interest groups can be sorted-out: a) Corporate managers; b) Attorneys; c) Banks and financial institutions; d) Unsecured creditors and “dispersed” creditors or bondholders; e) Shareholders; f) Workers. See: Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311, 343 - 344 (1992 - 1993).

insolvency proceeding¹³. However, bankruptcy laws often curb these original entitlements in order to pursue goals that are not always motivated by efficiency concerns. For instance, in some jurisdictions the general stay of creditors' claims suffers exceptions aimed at protecting specific claims, such as those of employers or security holders¹⁴. Pre-insolvency entitlements are often altered in order to advantage specific constituencies, such as the employees or the "community", or to pursue specific policy goals and political equilibriums within the domestic political sphere.

b) Fraudulent and preference transfers. Furthermore, bankruptcy laws avoid or nullify transfers made by the debtor before his or her default that favor some creditors over other ones ("preference transfers") and transfers made at underprice ("fraudulent transfers"). Avoidance rules depart from general private law, under which creditors' reaction mechanisms are based on a "first come first served basis" so that the fastest creditors are legitimately preferred over other ones. At the same time, certain transfers that are made by a firm in financial distress, with the aim to continue its operation, are often excluded from avoidance, otherwise the firm would have no chance of recovery. While the rationale of preference and fraudulent transfer rules is clear and generally accepted, their legal prerequisites are highly debated and are a politically sensitive matter, since they affect the relations among creditors and between

¹³ The most relevant example of a rule that respects the pre-bankruptcy bargain is the preemption right of secured creditors, backed by "rights in rem" like mortgages or liens.

¹⁴ For a summary of some carve-out to the general stay of creditors claim see Insol Report, 12. On the relevance of insolvency rules for state's policies see PAUL J. OMAR, EUROPEAN INSOLVENCY LAW, 6 – 9 (2004).

creditors and debtors. In this regard, it is realistic to predict that sophisticated lenders, like banks and financial institutions, have a strong preference for legislations that restrict avoidances of preference and fraudulent transfers, while small or non-sophisticated creditors, having a weak influence over debtor's behaviors, will favor a legislation that increases the likeliness that transfers or repayments made in the vicinity of insolvency are avoided by the bankruptcy trustee.

To sum up, bankruptcy law pursues the primary goal of efficient allocation of debtor's assets among all stakeholders, by addressing creditors' coordination problems. Additionally, bankruptcy law produces redistributive effects among stakeholders and a number of bankruptcy rules pursue redistributive goals departing from mere efficiency or from the respect of pre-bankruptcy bargains and entitlements.

III. INTERNATIONAL BANKRUPTCY LAW AND THE ALLOCATION OF POWERS WITHIN FEDERAL STATES

A. International bankruptcy law

Corporations and firms do not restrict their activities to the territory of their "home" jurisdiction and even small or medium-size firms often have assets, creditors or suppliers in countries different from the country of incorporation. If the firm goes bankrupt, therefore, each of the states involved has a legitimate

political interest in regulating the insolvency, even if the debtor is incorporated in a different country.

To understand this, we can imagine the extreme case of a corporation incorporated in country A, having all their assets, activities and creditors in country B. In this situation, country B is more affected than country A by firms' default and, additionally, the courts of country A would face significant obstacles in seizing assets located on a different territory. This example puts in clear words the policy issues raised by such cross-border insolvencies, namely: (i) what is the optimal choice-of-law and choice-of-jurisdiction criterion; and (ii) what is the optimal "reach" of court's powers, that is to say whether such powers extend (or should extend) to assets located on other states' territory.

These questions are particularly relevant for creditors and other stakeholders, who have the interest to know in advance which insolvency law will apply in case of default of their debtor. Indeed, bankruptcy rules establish creditors' rights and powers in case of insolvency, and, ultimately, the level of riskiness of the contractual relation. We can say, therefore, that such rules are implicit parts of the contract and, therefore, potential creditors discount the "value" of the applicable law from the cost of credit. In order to "price" bankruptcy rules, creditors have to know in advance which law will apply in case of default¹⁵. For example: before

¹⁵ See: Miguel Virgos & Etienne Schmit, *Report on the Convention on Insolvency Proceedings*, Council of the European Union, Doc. 6500/96/EN (1996) Par. 75. (it was the official report to the planned convention on cross-border insolvencies, which never came into force but whose content was put into the Insolvency Regulation, hereinafter, "Virgos - Schmit Report"): "Insolvency is a foreseeable risk. It is therefore important that international jurisdiction [...] be based on a place known by the debtor's potential creditors". See also Horst Eidenmüller, *Der Markt für internationale*

signing a financial agreement, banks consider whether, and to what extent, the applicable law protects liens in case of default and whether the repayment of the credit will be avoided in case of default of the debtor.

If a debtor's activities are connected with a number of jurisdictions, it is necessary to establish which one regulates the debtor's default. In this regard, three partially overlapping policy theories have been developed: universalism, territorialism¹⁶ and the contractual theory.

a) *Universalism*. According to universalism, a single jurisdiction should be competent to regulate insolvencies and the distribution of a debtor's assets to creditors all over the world, regardless of the location of such assets¹⁷. Under this model, all countries agree upon the competence of a single law and of a single court, namely that of the debtor's "home country". Each state, therefore, should partially abdicate from the power to regulate bankruptcies involving domestic assets or creditors, whenever another state is the debtor's "home country"¹⁸. For choice-of-law purposes, it is necessary to assess which is the "home country" of a

Konzerninsolvenzen: Zuständigkeitskonflikte unter der EuInsVO, NEUE JURISTISCHE WOCHENSCHRIFT, 2004, 3456; Bob Wessels, *Current topics on international insolvency law* (Kluwer, 2004) 160.

¹⁶ Both universalism and territorialism implicitly raise the issue of state's territorial dimension. The bigger a state's territorial extension, the more the effects of territorialism are similar to those of universalism; and if one state's sovereignty extends over the entire market, where corporations have their business and their assets (or if we imagine a "state-world" extended over the entire planet), territorialism and universalism coincide.

¹⁷ Jay Lawrence Westbrook, *Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*, 65 AM. BANKR. L. J., 457 (1991); Lucian Arye Bebchuk & Andrew T. Guzman, *An Economic Analysis of Transnational Bankruptcies*, 42 J. L. & ECON., 775 (1999); Andrew T. Guzman, *International Bankruptcy: In Defense of Universalism*, 98 MICH. L. REV. 2177 (1999 - 2000).

¹⁸ Westbrook, *Theory and Pragmatism*, 469.

debtor and in this regard the flexible concept of "centre of main interests" has emerged as a viable criterion at the international level¹⁹.

b) Territorialism. By contrast, according to "territorialism", each state should be competent to seize a debtor's assets located in its domestic territory²⁰. Territorialism, therefore, stems from the traditional concept of state sovereignty as the exclusive dominion over a territory and is underlined by the idea that bankruptcy law is essentially a mechanism to seize assets and distribute them to creditors according to domestic priorities and criteria rather than to favor debtor's recovery. Indeed, the main rationale of territorialism is to protect local interests. Advocates of territorialism argue that creditors only consider debtors' assets located on the domestic territory and that they will be better-off if the domestic law has exclusive power to regulate distribution rules and criteria²¹. Finally, one of the reasons for a territorialist approach is to prevent forum shopping: universalists claim that under their model a single court, namely that of the "home country" of the debtor, would be clearly competent, but advocates of territorialism reply that this claim is unrealistic for big corporations without a clearly defined "home country"²².

c) Contractualism. Finally, pursuant to a third approach, called "contractualism", corporations should have the right to choose, out of a "menu" of options, the

¹⁹ John A.E. Pottow, *The Myth (and Realities) of Forum Shopping in Transnational Insolvency Cases*, 32 BROOK. J. INT'L LAW, 785, 791 - 192 (2007).

²⁰ Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post-Universalist Approach*, 84 CORNELL L. REV. 696 (1998 - 1999).

²¹ LoPucki, *Cooperation*, *supra* note 20, 711

²² LOPUCKI, *COURTING FAILURE* (2005) 209.

jurisdiction that will regulate bankruptcy²³. To be sure, the courts of such jurisdiction should have the power to seize a firm's assets regardless of their location and to distribute them according to domestic priorities and criteria. In other words, the contractualist approach diverges from universalism only as to the preferred choice-of-law criterion (namely the debtor's choice instead of a mandatory criterion), not as to the reach of courts' powers, and can be relabeled as an "optional universalism" to distinguish it from the "traditional" universalism that follows mandatory choice-of-law and jurisdiction criteria.

B. Power allocation within federal states

Within federal states, policy issues emerge that are partially similar to those arising in the international arena, since corporations chartered by one of the member states can have assets and creditors in other states. However, differently from the international arena, in federal legal system insolvencies might be governed by a federal court and regulated by federal rules, instead of by courts and rules of the member states. Consequently, the question arises as to whether the central government should be competent to govern bankruptcies and to establish bankruptcy law rules. In other words, the question arises of the "vertical" distribution of powers between the federal level and the member states.

²³ Robert K. Rasmussen, *A New Approach to Transnational Insolvencies*, 19 MICH. J. INT'L L. 1 (1997 - 1998) and *Resolving Transnational Insolvencies through Private Ordering*, 98 MICH. L. REV. 2252 (1999 - 2000).

This is a case of the more general issue of power allocation in federal states. Pursuant to a public welfare approach, the political body that comprehends all externalities produced by a certain industry should govern it²⁴. The reason is that, if an industry sector regulated by a certain jurisdiction produces negative externalities on another territory, politicians in the former will avoid regulating such sectors, since their voters will not suffer negative effects (s.c. "spillover effect"). In general, we can say that the larger the jurisdiction, the less likely are spillover effects, but this "distance" between regulators and citizens might produce both a lack of accountability and resources' misallocation²⁵.

Federal systems can be either decentralized or centralized. Under decentralized regimes, insolvency law is governed by member states and the federal body does not have any competence in this field. This model raises the policy issue as to which member state should be competent to govern insolvencies. In this regard,

²⁴ Thomas S. Ulen, *Economic and Public-Choice Forces in Federalism*, 6 GEO. MASON L. REV. 921, 928 (1997 - 1998): "If the cost and benefits of an action, whether public or private, stray across jurisdictional lines, then the highest level of government that can fully internalize the costs and benefits of the action ought to take responsibility". However, differently from this rather optimistic public-welfare theory, public choice theory tells another story and predicts that politicians maximize the "political support" they receive from interest groups. This theory suggests that a certain issue will be regulated at the level that maximizes the political support gained by politicians; therefore, in a federal State like the U.S., the Congress will delegate a certain legislation to local regulators (the states) only if national politicians obtain a higher political support in this way. This outcome depends on the action and on the dimension of interests' groups and on their relations with political forces: Decentralization will prevail, hence, if all involved interests groups have an interest to avoid federalization and if interest groups are not uniform in all involved member states so that deference to local regulator maximizes political support. See: Jonathan R. Macey, *Federal deference to Local Regulators and The Economic Theory of Regulation: Toward a Public-Choice explanation of Federalism*, 76 VA. L. REV., 265 (1990).

²⁵ A certain regulation or a certain allocation of goods is efficient in intra-jurisdictional sense when it minimizes the costs paid by the constituencies of a specific jurisdiction in order to maximize public utility. In other words, intra-jurisdictional efficiency takes into account only expenditures and utility within a specific jurisdiction. By contrast, inter-jurisdictional efficiency means that, among a number of interacting jurisdictions (such as those of a federal state or a union of states), the regulation minimizes the cost suffered by all constituencies of all jurisdictions in order to maximize their collective demand of goods. See: Robert P. Inman & Daniel L. Rubinfield, «Federalism» in *Encyclopedia of Law and Economics*, 661, 668 (1999).

decentralized models can adopt mandatory choice-of-law and choice-of-forum criteria or, alternatively, can leave debtors the power to opt for the preferred jurisdiction. In contrast, under centralized regimes the federal government regulates corporate bankruptcies and member states are preempted.

a) Decentralization with mandatory choice-of-law and choice-of-forum criteria. The first option is to enact unified mandatory choice-of-law and forum criterion for the whole federation. The unified choice-of-law and forum criterion selects the state that is competent to govern a specific insolvency, so that its competence is valid and recognized by all members of the federation. We will see in the following paragraphs that a modified version of this model is adopted in the European Union. As regarding the "reach" of domestic courts' powers, mandatory decentralization is commonly coupled with the "universality" principle, with the consequence that the competent court extends its powers over a debtor's assets located in any member state. Thus, there is just one single member state competent to govern a specific insolvency, and its power extends to assets and creditors located in any other member states²⁶.

b) Decentralization with free choice of law. Decentralized federal systems can give corporations free choice of the applicable bankruptcy law and of bankruptcy

²⁶ Decentralization might be associated with a territorialist approach. This would be the case if the choice-of-law and forum criterion were the location of debtor's assets or of debtor's branches. Coherently, each member state would govern the bankruptcy only regarding the assets located in their territory and according to domestic criteria and pecking orders. This alternative approach is adopted in the European Union as ancillary criterion for secondary proceedings, as we will see in the following paragraphs. Private actors, however, even under the current "modified universalism" of the Insolvency Regulation, can decide to form a corporate group and to incorporate an affiliate company in each member state where they have activities, plants and creditors. In practice, this corporate structure would produce a result identical to a territorial mandatory decentralization, but the decision will be left in the hands of private parties instead of the state .

venue. Under this “choice model”, bankruptcies are governed at state level and are regulated by rules enacted by member states; at the same time, the debtor can choose the preferred bankruptcy law and bankruptcy venue, among the different member states. Thus, this model accepts both law shopping and forum shopping. Additionally, like under a decentralized model with mandatory choice-of-law and forum criteria, to state’s powers can be granted either a universal or a territorial extension.

c) Centralized systems. As an alternative, bankruptcy law may be centralized or “federalized”. Under a purely centralized model, only the federal body, not the member states, enacts bankruptcy law. The highest level of centralization is reached when bankruptcy rules are enacted at federal level, with federal courts being simultaneously in place to govern bankruptcy proceedings. As we will see in the next paragraph, the U.S follows this model. If bankruptcy law is entirely centralized and federal courts govern bankruptcies, the question of the “reach” of courts powers does not arise at all, since federal courts are obviously competent to seize any and all of a debtor’s assets located in the territory of the federation. The issue of the competent bankruptcy venue, however, can nonetheless arise, as is the case in the U.S., if different federal courts are spread across the federal territory. Centralization of bankruptcy law, however, may be only partial. This would be the case, for instance, when federal states are competent to establish the rules to be applied to insolvencies, but member states’ courts retain the competence to govern insolvencies and to apply federal rules. Furthermore,

centralization of insolvency law might be even weaker, if the federal body simply enacts guidelines or directives aimed at harmonizing member states' laws.

IV. BANKRUPTCY LAW IN THE U.S. AND THE E.U.

A. U.S.: Federalization (with exceptions)

1. The rationale of federalization

In the U.S., while corporate law is state law, insolvency regulation is federal. In this regard, according to Article I, section 8 of the U.S. Constitution "[c]ongress shall have the power [...] to establish [...] uniform law on the subject of bankruptcies throughout the United States"²⁷. The origin of this "bankruptcy clause" is uncertain, and in the Constitutional Convention the debate upon this argument was not intense²⁸.

Certainly, the "bankruptcy clause" does not mandate a federal bankruptcy law, but simply empowers the federal government to enact such a law. Indeed, during the Eighteenth century a number of federal bankruptcy laws were enacted in order to respond to specific financial crises. Such acts, however, were only partial and were

²⁷ U.S. CONSTITUTION, art. I, § 8, cl. 1 § 4.

²⁸ David A. Skeel, *Rethinking the Line Between Corporate Law and Corporate Bankruptcy*, 72 TEX. L. REV. 470, 473 (1994). Probably, one of the reasons was to avoid that member states would adopt English traditional insolvency regimes, which were highly punitive for insolvent debtors and were considered by American revolutionaries as excessive restrictions to personal liberties: see REGIS NOEL, A HISTORY OF THE BANKRUPTCY CLAUSE OF THE CONSTITUTION OF THE UNITED STATES OF AMERICA, 1918, 67 – 84.

promptly repealed²⁹. The first coherent and stable federal bankruptcy act was enacted in 1898, that is to say more than one century after the Constitution was approved³⁰.

A uniform bankruptcy law for the whole nation became necessary in order to deal with the continental dimension of corporations' activities and to avoid discrepancies as to creditors' treatments across the Federation³¹, which would have jeopardized interstate commerce³². The uniformity rationale and the need to legislate at the highest territorial level seem to be the real policy reason for the enactment of a uniform bankruptcy law and, indeed, this rationale was mentioned in the sole passage of The Federalist Papers where Madison addressed the need of a federal bankruptcy law regime³³.

Additionally, federal courts have exclusive jurisdiction over bankruptcy cases, which cannot be filed in state courts³⁴. Within federal district courts, bankruptcies

²⁹ Act of Apr. 4, 1800, ch. 19, 2 Stat. 19, repealed by Act of Dec. 19, 1803, ch. 6, 2 Stat. 248; Act of Aug. 19, 1841, ch. 9, 5 Stat. 440, repealed by Act of Mar. 3, 1843, ch. 82, 5 Stat. 614; Act of Mar. 2, 1867, ch. 176, 14 Stat. 517, repealed by Act of June 7, 1878, ch. 160, 20 Stat. 99.

³⁰ Act of July 1, 1898, ch. 541, 30 Stat. 544, repealed by Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549.

³¹ Skeel, *Rethinking the Line*, *supra* note 28, 480 - 482 and DEBT'S DOMINION, A HISTORY OF BANKRUPTCY LAW IN AMERICA (2001), 35 - 39 (stressing that emerging national creditors' associations played a significant role and that the Congress needed to balance their needs with request of agrarian and populists of a pro-debtor legislation or no legislation at all).

³² Judith Schenck Koffler, *The Bankruptcy Clause and Exemption Laws: A Reexamination of the Doctrine of Geographical Uniformity*, 58 N.Y.U. L. Rev., 22, 54 (1983). However, despite the enactment of a federal bankruptcy act in 1898, bankruptcy law was not entirely uniform since U.S. states were considered free to keep own laws of assets exemptions: Koffler, *The Bankruptcy Clause and Exemption Laws*, 53 - 61 (1983).

³³ James Madison, The Federalist, No 42: "*The power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or their property may lie or be removed into different States, that the expediency of it seems not likely to be drawn into question.*"

³⁴ 28 U.S.C.S. § 1334.

are heard by a separate unit of bankruptcy judges³⁵, who are appointed by the Court of Appeal for a significantly long term of 14 years³⁶. The exclusive competence of federal courts to hear bankruptcy cases grants a certain degree of legal uniformity, although, as we will see hereunder, in the U.S. forum shopping is possible and the application of bankruptcy rules is not completely uniform across the bankruptcy courts.

2. Disharmonies behind uniformity

Despite the existence of a uniform bankruptcy law enforced in federal courts, creditors' interests are not always treated consistently throughout the U.S. Two main reasons emerge for this lack of uniformity: the partial application of state law within bankruptcy proceedings and forum shopping.

a. The application of state law in federal bankruptcy proceedings

³⁵ 28 U.S.C.S. § 157. The Federal District Court can refer cases arising under the bankruptcy code or in a bankruptcy proceeding ("core cases") to bankruptcy judges and can refer to the latter also cases related to a bankruptcy case ("noncore cases"). District Courts usually issue a general order of reference. In "noncore" proceedings, however, bankruptcy judges can not issue final decisions. See: *Phar-Mor, Inc. v Coopers & Lybrand* (1994, CA3 Pa) 22 F3d 1228. Additionally, the District Court can withdraw cases from the competence of bankruptcy judges for cause shown and has to withdraw a case from bankruptcy judge if the "resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce". 28 U.S.C.S. § 157(d). It is debated, however, under which circumstances such mandatory withdrawal is required. See: *Securities Investor Protection Corp. V. Madoff* (2011, NY) 2011 U.S. Dist. LEXIS 57645: "The mandatory withdrawal of the bankruptcy reference provision of 28 U.S.C.S. § 157(d) is construed narrowly to apply only in cases where substantial and material consideration of non bankruptcy federal statutes is necessary for the resolution of the proceeding. Consideration is substantial and material when the case requires the bankruptcy judge to make a significant interpretation, as opposed to simple application, of federal laws apart from the bankruptcy statutes."

³⁶ 28 U.S.C.S. §§ 151 – 152.

State laws apply also within federal bankruptcy proceedings and, in some cases, can preempt federal rules. Indeed, the most important function of bankruptcy law is to adjudicate preexisting rights and claims, which are created according to state law, not to federal law³⁷. Such preexisting entitlements can also be created by a statute, as is the case for statutory liens and security interests. Pursuant to the Bankruptcy Code §545, the bankruptcy trustee can avoid liens only under specific circumstances, which means that the vast majority of pre-existing liens, excluding only liens for rents, are not to be avoided and have priority over other credits. Consequently, states can impose their own priority ranking over national ones simply by qualifying a certain claim as a "lien"³⁸.

The picture, however, is complicated by the fact that federal bankruptcy law often modifies the content of state law and the preexisting entitlements. For example, the Bankruptcy Code places a number of limits to set-off rights existing under state law³⁹. Additionally, the trustee can avoid fraudulent transfers made by the debtor two years before the bankruptcy petition⁴⁰. Regarding fraudulent transfers,

³⁷ See: *Erie Railroad Co v. Tompkins* 304 U.S. 64 (1938): "There is no general common law. Congress has no power to declare substantive rules of common law applicable in states [...]"

³⁸ LoPucki, *Cooperation*, *supra* note 20, 745 - 748 (arguing in favor of "cooperative" territorialism); Jay Lawrence Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276, 2298 (1999/2000). To establish the applicable state law, a possible solution for federal bankruptcy courts is to follow choice-of-law criteria of the state of the forum: *Klaxon Company v. Stentor Electric Manufacturing Co.* 313 U.S. 487 (1941). However, *Klaxon* was referred to federal jurisdiction on diversity, aiming at avoiding "vertical" forum shopping. It is unclear whether the *Klaxon* doctrine should be extended also to other competences of federal courts; see: John T. Cross, *State Choice of Law Rules in Bankruptcy*, 42 OKLA. L. REV. 531, 573 - 576 (1989) (the federal court should select substantive state law that would be chosen by the state court that would adjudicate the dispute outside of bankruptcy) and Alex Mills, *Federalism in the European Union and the United States: Subsidiarity, Private Law and the Conflict of Law*, forthcoming on U. PENN. J. INT'L LAW, www.ssrn.com, 54 (2010).

³⁹ 11 U.S.C. § 553.

⁴⁰ 11 U.S.C. § 548(1).

the relations between state and federal law is more complex. State laws often have their own rules on fraudulent conveyance that might depart from that of the federal bankruptcy law. The bankruptcy's trustee should apply state law on fraudulent transfer, instead of federal ones, if the former permit the avoidance of a transaction that could not be avoided under federal law⁴¹.

b. Choice of bankruptcy venue criteria and forum shopping

In the U.S., despite the federalization of bankruptcy law, forum shopping is possible. Bankruptcy case placers can shop among different venues, since pursuant to the bankruptcy venue statute⁴² bankruptcies can be filed either (i) in the court where the debtor's has its domicile or residence (meaning the place of incorporation for companies⁴³), (ii) or in the court where is the debtor's principal place of business (iii) or in the court where are debtor's principal assets, or (iv) in the place where the bankruptcy case of an affiliate is already pending. These criteria to establish the proper bankruptcy venue can be easily shifted or manipulated, so that often the debtor can choose the preferred bankruptcy court. The motivation for forum shopping is that different bankruptcy courts can interpret and apply bankruptcy law differently.

⁴¹ 11 U.S.C. § 544(b). A typical example is when state law allows avoiding transfers made within a period before filing longer than such provided for by federal bankruptcy law. However, under specific circumstances, fraudulent conveyances provided for by the bankruptcy code might be more extended than state law ones, since Section 544 of the Code allows to avoid transfers by applying state law only if the trustee identify a specific creditor who could avoid the transfer under state law, while Section 548 (general provision of avoidance under federal law) does not require to identify such creditors: Cross, *State Choice of Law Rules in Bankruptcy*, *supra* note 38, 541 nt. 32.

⁴² 28 U.S.C. § 1408.

⁴³ *In re Ocean Props. of Del. Inc.*, 95 B.R. 304, 305 (Bankr. D. Del. 1988)

In recent years, the Delaware District court has become the most important federal venue for corporate bankruptcies and legal scholars widely debate whether this race to file in Delaware is efficient or not. According to some scholars, big corporations choose to file in Delaware because its court is more "debtor-friendly" and facilitates inefficient corporation's recoveries. The proof of this is that one third of the corporations that filed for Chapter 11 in Delaware during the 1990s, filed for bankruptcy a second time within a few years⁴⁴. Other scholars, by contrast, hold that the race to Delaware is motivated simply by efficiency and by the predictability of the Delaware bankruptcy case law⁴⁵, or by a form of beneficial "professional" competition among federal judges⁴⁶. Certainly, it can be said that the choice of bankruptcy venue in the U.S. is not irrelevant and that the option for a certain court may influence the outcome of the proceeding.

B. E.U.: From mandatory choice-of-law criteria to a chaotic choice model

1. The rationale of the Insolvency Regulation

In contrast to the U.S., in the European Union, bankruptcy law is under the exclusive jurisdiction of the member states. The EC Regulation 1346/2000

⁴⁴ Lynn M. LoPucki & Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a 'Race to the Bottom'*, 54 VAND. L. REV., 231 (2001).

⁴⁵ David A. Skeel, *What's So Bad About Delaware?*, 54 VAND. L. REV., 309 (2001); Robert K. Rasmussen & Randall S. Thomas, *Timing Matters: Promoting Forum Shopping by Insolvent Corporations*, 94 NW. U. L. REV. 1357 (2000) (race to file in Delaware is mainly beneficial because Delaware judge handle prepackaged workouts faster than other courts, while the efficiency for other Chapter 11 cases is uncertain); Robert K. Rasmussen & Randall S. Thomas, *Whither the Race? A Comment on the Effects of the Delawarization of Corporate Reorganizations*, 54 VAND. L. REV., 283, 303 (2001) (LoPucki and Kalin do not explain the reasons of the refiling cases); David A. Skeel, *European Implication of Bankruptcy Venue Shopping in the U.S.*, 54 BUFF. L. REV. 439 (2006 - 2007).

⁴⁶ Marcus Cole, *"Delaware is Not a State": Are We Witnessing Jurisdictional Competition in Bankruptcy?*, 55 VAND. L. REV., 1845 (2002).

(hereinafter, the "Insolvency Regulation")⁴⁷, however, has unified the choice-of-law and choice-of-forum criteria for all member states⁴⁸. At a first glance, therefore, the Insolvency Regulation follows a decentralized model with mandatory choice-of-law and forum criterion, since insolvency law is enacted by member states and governed by state courts, but choice-of-law and choice-of-forum criteria are unified and are not at disposal of the debtors. The European Insolvency Regulation combines this model with the universality principle, according to which just one jurisdiction is competent to control the main insolvency proceeding and the powers of such jurisdiction extend to all assets of the debtor and to all creditors, regardless of their location.

The main bankruptcy proceeding should be opened in the jurisdiction where the Center of Main Interests (hereinafter "COMI") of the debtor is. Indeed, one of the first concerns of the Insolvency Regulation is to avoid uncertainties as to the competent jurisdiction and to block forum shopping⁴⁹. For this reason, the COMI is established by mandatory criteria that have validity over the entire E.U. Following this logic, pursuant to the Insolvency Regulation, a debtor's COMI is in the country where he or she "conducts the administration of his [or her] interests on a regular basis and is therefore ascertainable by third parties"⁵⁰.

⁴⁷ The Insolvency regulation applies to debtors' having their Center of the Main Interests within the E.U. (excepted Denmark, to which the Insolvency Regulation does not apply: Recital 33 Insolvency Regulation).

⁴⁸ In the Insolvency Regulation, however, there are a certain number of substantive rules, related to specific issues such as reservation of title, the right to file for opening a secondary proceeding or the rule on advance payment of expenses. See: Bob Wessels, *Harmonization of Insolvency Law in Europe*, EUROPEAN COMPANY LAW, 29, (No 1, 2001).

⁴⁹ Recital 4 Insolvency Regulation.

⁵⁰ Recital 13 Insolvency Regulation.

The COMI, therefore, is a factual criterion, that needs to be assessed on a case-by-case basis. To simplify this issue and to enhance predictability, a corporations' COMI is presumed to be in the country of the registered office, unless the contrary is proven⁵¹. As a result, if this presumption is not rebutted, the same State is competent for both corporate and bankruptcy rule,, which is consistent with the strong correlations between these sets of rules⁵². Conversely, if an insolvent corporation provides evidence that its COMI is in a country different from the country of its registered office, bankruptcy law of a state different from the state of incorporation will apply. Pursuant to case law of the European Court of Justice (hereinafter "ECJ"), in order to prove that the COMI is different from the registered office, evidence should be provided of both the following elements: (a) that the corporate headquarter is not located in the state of the registered office and (b) that this fact was ascertainable by third parties⁵³.

Despite the uniformity of choice-of-law criterion across the EU, however, in recent years conflicts of jurisdiction have been intensively litigated in courts of EU member states, although they have rarely reached the ECJ⁵⁴. The Insolvency Regulation provides for a pragmatic solution to conflict of jurisdiction, namely the "priority principle". According to recital 22 of the Regulation, the "[r]ecognition of

⁵¹ Article 3 Insolvency Regulation.

⁵² John Armour, *Who should make corporate law: EC Legislation versus regulatory competition*, CURRENT LEGAL PROBLEMS, 369, 401 - 403 (2005).

⁵³ See: ECJ *Eurofood IFSC Ltd*, C-341/04 [2006] ECR-I 1078.

⁵⁴ Beyond the *Eurofood* case mentioned above, the ECJ has addressed the interpretation of the Insolvency Regulation in the following opinions: European Court of Justice C-1/04 *Staubitz-Schreiber* [2006] ECR-I 00701 (transfer of the COMI after filing, but before opening of the proceeding, does not shift jurisdiction); European Court of Justice C-330/07, *Frick Teppichboden Supermärkte GmbH v. Deko Marty Belgium B* [2009] www.curia.europa.eu (avoidance of fraudulent conveyances and claw-back actions belong to "insolvency law"); European Court of Justice, C-444/07 *MG Probud Gdnia sp. z. o.o.* [2010].

judgments delivered by the courts of the Member States should be based on the principle of mutual trust. To that end, grounds for non-recognition should be reduced to the minimum necessary." Correspondingly, "[a]ny judgment opening insolvency proceedings handed down by a court of a Member State which has jurisdiction pursuant to Article 3 shall be recognized in all the other Member States from the time that it becomes effective in the State of the opening of proceedings". In practice, this "priority principle" leads to a general "first-come, first-served" rule, pursuant to which the first domestic court that opens a proceeding prevails over other courts. This rule may lead to a race among potential case-placers to file in their preferred court⁵⁵. Consequently, the fastest court will prevail and states might engage in a competition to introduce a fast or provisional opening proceeding, without adequate evidence as to the real location of the COMI⁵⁶.

2. Exceptions to universalism in the Insolvency Regulation

After this brief description, the European Insolvency Regulation seems to coherently follow the universality model. Things are more complicated, however, and the Regulation is coherent only at the surface.

a. What is "insolvency law"?

⁵⁵ Luca Enriques & Martin Gelter, *How the old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law*, 81 TULANE L. R. 576, 635 - 637 (2007).

⁵⁶ Thomas Bachner, *The battle over jurisdiction in European insolvency law*, EUROPEAN COMPANY FINANCIAL REVIEW, 310, 318 (2006).

The first issue is “what is insolvency law for the purpose of the regulation”? This question is particularly relevant if the COMI of an insolvent corporation is located in a member state different from the state of incorporation. In this case, bankruptcy is governed by the state of the COMI, while corporate law matters are regulated by the state of incorporation. In this circumstance, during the insolvency proceeding the question arises as to which issues are to be regulated by the state of the COMI and which by the state of incorporation (as belonging to corporate law) or by other states. This is a classical question of characterization in private international law, which may produce a conflict of jurisdictions whenever two states disagree upon the extension of what “insolvency law” is, even if the choice-of-law criteria are identical.

The Insolvency Regulation addresses this issue by enumerating a number of matters that belong to “insolvency law” and should be regulated by the state of the COMI. In particular, the state of the COMI regulates⁵⁷: *“(a) against which debtors insolvency proceedings may be brought on account of their capacity; (b) the assets which form part of the estate and the treatment of assets acquired by or devolving on the debtor after the opening of the insolvency proceedings; (c) the respective powers of the debtor and the liquidator; (d) the conditions under which set-offs may be invoked; (e) the effects of insolvency proceedings on current contracts to which the debtor is party; (f) the effects of the insolvency proceedings on proceedings brought by individual creditors, with the exception of lawsuits pending; (g) the claims which are to be lodged against the debtor’s estate and the treatment of*

⁵⁷ Article 4(2) Insolvency Regulation.

claims arising after the opening of insolvency proceedings; (h) the rules governing the lodging, verification and admission of claims; (i) the rules governing the distribution of proceeds from the realisation of assets, the ranking of claims and the rights of creditors who have obtained partial satisfaction after the opening of insolvency proceedings by virtue of a right in rem or through a set-off; (j) the conditions for and the effects of closure of insolvency proceedings, in particular by composition; (k) creditors' rights after the closure of insolvency proceedings; (l) who is to bear the costs and expenses incurred in the insolvency proceedings; (m) the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors."

In addition, according to the ECJ's case law, all actions deriving from a bankruptcy should be regulated by the same jurisdiction as the COMI and governed by its courts (s.c. *vis attractiva concursus*), even if they are not explicitly enumerated in article 4(2) of the Insolvency Regulation⁵⁸. To put it simply, such matters belong to "insolvency law", not to corporate law. Consequently, certain actions that are typically designed to address the agency problem between shareholders and creditors in the aftermath of an insolvency, such as the board's liability or the

⁵⁸ European Court of Justice, C-133/78, *Gourdain v. Nadler* [1979] R-I 733 (on the French *action en comblement du passif*) and European Court of Justice C-330/07, *Frick Teppichboden Supermärkte GmbH v. Deko Marty Belgium B* [2009] www.curia.europa.eu (avoidance of fraudulent conveyances and claw-back actions belong to "insolvency law"); European Court of Justice, C-444/07 *MG Probud Gdnia sp. z. o.o.* [2010]. See: Alexander Schall, *The UK Limited Company Abroad - How Foreign Creditors are Protected after Inspire Art*, EUROPEAN BUSINESS LAW REVIEW, 1534, 1553 (2005); Luca Enriques & Martin Gelter, *Regulatory Competition in European Corporate Law and Creditors Protection*, EUROPEAN BUSINESS ORGANIZATION REVIEW, 417, 440 (2006).

avoidance of fraudulent or preference transfers, are to be regulated by the member state where the COMI is located, not by the state of incorporation⁵⁹.

b. Modified universality

The first and most evident exception to the competence of the state of the COMI is the power to open secondary proceedings with territorial effects in any member state where the debtor has an "establishment"⁶⁰. Such parallel proceedings are restricted to the debtor's assets located within the territory of the member state⁶¹ and follow exclusively bankruptcy rules of such state⁶². Consequently, whenever a corporation has branches or establishments in different countries, each of them is competent to open a secondary proceeding, so that the distribution of the assets located in their territory will follow their domestic rules and criteria.

This is a significant breach in the logic of the universality principle⁶³, which can lead to unpredictable outcomes if the insolvent corporation has activities and establishments in more than one country. Imagine that a big corporation has an establishment in each member state where it is active: if this corporation goes bankrupt, each of these member states is competent to open separate territorial proceedings that will erode the competence of the main proceeding opened in the

⁵⁹ See Christoph G. Paulus, *Konturen eines modernen Insolvenzrechts - Überlappungen mit dem Gesellschaftsrecht*, DER BETRIEB, 2523 (2008), according to which this division is quite artificial and creates the risk of significant distortions of the corporate governance mechanism established within a certain jurisdiction.

⁶⁰ Article 2 Insolvency Regulation. To be sure, a similar approach is followed by U.S. law (11 U.S.C. § 1502), according to the UNCITRAL Model Law (Article 17 and Article 28), but the "modified universalism" provided for by US law is directed toward foreign countries and does not apply to intra US relations. See: Gerald Mc Cormack, *Jurisdictional Competition and Forum Shopping in Insolvency Proceedings*, CAMBRIDGE LAW JOURNAL, 169, 174 – 175 (2009).

⁶¹ Article 27 Insolvency Regulation.

⁶² Article 28 Insolvency Regulation.

⁶³ See IAN F. FLETCHER, *INSOLVENCY IN PRIVATE INTERNATIONAL LAW*, 371 (London 2005)

state of the COMI. In this case, as a matter of fact, the universalist approach of the European Insolvency Regulation might turn into a sort of cooperative territoriality, since many states are competent to govern the liquidation of domestic assets and will be coordinated by the court of the main proceeding.

c. Exceptions and carve-outs to the law of the COMI

The goals of uniformity and legal predictability are breached also by the exception or carve-outs to the law of the COMI. I will mention two main exceptions that directly affect the relations between creditors⁶⁴.

The first and most significant of these exceptions is related to avoidance and claw-back actions. Pursuant to Article 4(2) (m) of the Regulation, the law of the COMI should regulate these actions. However, pursuant to article 13, transactions that would be avoided under the law of the COMI, remain valid if the person who benefited from it gives evidence that (a) such an act is "*subject to the law of a Member State other than that of the State of the opening of proceedings*" and (b) that the law applicable to the act "*does not allow any means of challenging the act in the relevant case*". In other words, the law of the transaction preempts the law of the COMI if the former does *not* allow the avoidance. The Insolvency Regulation, therefore, follows a policy rationale that is quite opposite to that of U.S. law, where state law applies only if it allows the avoidance of a transaction that could not be

⁶⁴ Other exceptions are related to: set-off rights (article 6 Insolvency Regulation), reservation of title (article 7 Insolvency Regulation), contracts related to immovable properties (article 8 Insolvency Regulation), payment systems and financial markets (article 9 Insolvency Regulation), employment contracts (article 10 Insolvency Regulation), rights subject to registration (article 11 Insolvency Regulation), patents and trade marks (article 12 Insolvency Regulation), third parties purchaser (article 14 Insolvency Regulation) and effects on pending lawsuits (article 15 Insolvency Regulation).

avoided under federal law. To sum: the U.S. vertical power allocation facilitates claw-back actions, while the E.U. solution dislikes such avoidances.

The second significant exception to the law of the COMI is related to "rights in rem"⁶⁵. According to article 5, "[t]he opening of insolvency proceedings shall not affect the rights in rem of creditors or third parties in respect of tangible or intangible, moveable or immoveable assets — both specific assets and collections of indefinite assets as a whole which change from time to time — belonging to the debtor which are situated within the territory of another Member State at the time of the opening of proceedings". This rule reflects the idea that the bankruptcy proceeding should respect the pre-bankruptcy entitlements. If the law of the COMI could disregard preexisting rights, such as securities, legal certainty would be at risk and interstate trade would be jeopardized⁶⁶. Consequently, if a creditor obtains from the debtor a security characterized as "right in rem"⁶⁷, such as a pledge, this security should be respected in the insolvency proceeding. In practice, this means that the law of the state where the asset is located might modify the

⁶⁵ Mc Cormack, *Jurisdictional Competition*, *supra* note 60, 175.

⁶⁶ Recital 25, Insolvency Regulation.

⁶⁷ To be sure, the characterization of a certain claim as "right in rem" under the Insolvency Regulation is debated. A common view acknowledges that such characterization should be made according to the law of member state to which pre-insolvency conflict rules of state of the *forum* refer. However, other authors claim that the characterization should be independent, so that there should be a single concept of "right in rem" for the Insolvency Regulation. See: MICHAEL VEDER, CROSS-BORDER INSOLVENCY PROCEEDINGS AND SECURITY RIGHTS, 332 – 336 (2004) (who makes a case in favor of independent interpretation); FLETCHER, INSOLVENCIES IN PRIVATE INTERNATIONAL LAW, *supra* note 63, 406 (autonomous characterization by each member state); OMAR, EUROPEAN INSOLVENCY LAW, *supra* note 14, 161 – 164.

ranking established by the law of the COMI, to the advantage of secured creditors, by labeling a certain claim as a “right in rem”⁶⁸.

3. Does the Insolvency Regulation really follow a decentralized model with mandatory choice-of-law and forum criterion?

At a first glance, the Insolvency Regulation provides for a mandatory choice-of-law and choice-of-forum criterion for the all member states of the European Union (the COMI). The idea behind this solution is that each debtor has a single and clearly identifiable COMI and that this simple mechanism will enhance legal predictability. To help assess the location of the COMI, the Regulation presumes that it coincides with the state of incorporation.

The mechanism of the Regulation was aimed at avoiding forum and law shopping, by starting from two implicit premises. The first premise was that the European corporations did not significantly extend their activities outside their home country, so that their COMI could be easily assessed. The second premise was that corporations could not “reincorporate” in another member state without liquidating in the original one. These premises are not valid anymore, however, which put the mechanism of the Regulation into a deep functional crisis.

Firstly, European corporations have increasingly extended their activities over the whole territory of the European Union. This fact is to be celebrated as a success of market integration policies, aimed at attaining a single internal market in the EU.

⁶⁸ VEDER, CROSS-BORDER INSOLVENCY PROCEEDINGS, *supra* note 67, 344.

At the same time, the continental extension of European corporations also increases the uncertainties as to the location of their COMIs.

The second and even more significant development that puts at risk the whole architecture of the Regulation is corporate mobility. As we have seen above, the COMI is presumed to coincide with the country of incorporation. The goal of this rule is to increase predictability *ex ante*, since the creditors need to know at the moment of contracting which law will be applied in case of insolvency, so that they can discount the “value” of that law from the price of credit⁶⁹.

The presumption that the COMI coincides with the registered office only grants legal predictability if divergences between the registered office and the “real” COMI are rare, and if cross-border mobility of the registered office is impossible or extremely difficult. Both these premises, however, are not anymore realistic due to the evolution of E.U. law. Firstly, thanks to the ECJ's case law, a corporation's headquarter can be placed in a member state different from the state of incorporation (provided that the latter accepts this dissociation)⁷⁰. In addition, in 2005 a Directive regulating cross-border mergers was enacted: these are now viable, although time consuming, mechanisms to transfer the registered office from one country to another, by incorporating a shell-company in the host country

⁶⁹ See: Virgos – Schmit Report, § 75: “the registered office normally corresponds to the debtor's head office”.

⁷⁰ European Court of Justice C-212/97, *Centros Ltd v Erhvervsog Selskabsstyrelsen* [1999] ECR I-1459; European Court of Justice C-208/00, *Überseering BV v Nordic Construction Company Baumanagement GmbH* [2002] ECR I-9919; European Court of Justice C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art*, [2003] ECR I-1095.

and then merging into it⁷¹. Finally, a recent decision of the ECJ has declared, although only *obiter*, that the right to transfer abroad the registered office from one member state to another, with the aim to convert into a corporation's type of the latter state, is protected by the E.U. freedom of establishment⁷².

Due to these developments, it is increasingly common for corporations to dissociate their activities and headquarters from the registered office or to transfer their registered office abroad. Consequently, the presumption that the COMI coincides with the registered office does not produce the same effects that were envisaged by the drafters of the Insolvency Regulation⁷³. First, a corporation's headquarter can be legitimately placed in a member state different from the country of incorporation. Secondly, by transferring the registered office abroad or by entering into a cross-border merger, the COMI is also shifted into the new country (provided that creditors do not prove that it is still in original state). In this way it is possible *de facto* to shift the COMI to another state and to select the preferred bankruptcy law to be applied in case of default. Despite the original intention of the Regulation, the evolution of E.U. law has changed the legal scenario and has converted the Insolvency Regulation from a mechanism of decentralization with a mandatory choice-of-law and forum criterion into a sort of

⁷¹ If the "arrival" country follows the "Real Seat Theory", the emigrating company needs to transfer there also its headquarter, but if the new country does not require domestically incorporated companies to have also the headquarter on the same territory, such corporation can simply reincorporate there without transferring any physical assets or the headquarter.

⁷² European Court of Justice, C-210/06, *CARTESIO Oktató és Szolgáltató* [2008] ECR I-09641. Additionally, even in a country like Germany that prohibits domestic companies to transfer abroad the registered office, the legal practice has found out a way to avoid such prohibition.

⁷³ See also Menjucq, *EC-Regulation No 1346/2000 on insolvency proceedings and groups of companies*, European Company Financial Review, 136 – 137 (2008)

optional regime. Corporate debtors, however, even by transferring their headquarters abroad, or by entering in a cross-border merger, cannot be sure to have really shifted the jurisdiction to the envisaged member state⁷⁴. The European optional regime, therefore, is neither transparent nor certain.

C. Conclusions

In the preceding pages, I have described the U.S. and E.U. models of “vertical” power allocation over bankruptcies. The U.S. has adopted a pretty coherent model, where bankruptcy law is entirely federalized and is governed by federal courts. In contrast, the European Model is much more confused. On paper, in the E.U. model no option is allowed for the preferred bankruptcy regime, yet the European model reveals a number of uncertainties. Firstly, despite the main insolvency proceeding being in the state of the COMI, secondary proceedings with territorial efficacy can also be opened in states where the debtor has establishments. Furthermore, the evolution of E.U. law allows forum and law shopping, since corporations can now reincorporate in a different member state by way of cross-border mergers. The original decentralized model, where forum and law shopping were avoided through mandatory choice-of-law and choice-of-forum criteria, has now been converted into a hidden choice model, whereby corporations can opt for their preferred insolvency law by transferring their registered office into another

⁷⁴ Marek Szydło, *Prevention of Forum Shopping in European Insolvency Law*, EUROPEAN BUSINESSES ORGANIZATION REVIEW, 253, 261 (2010)

member state, unless creditors give evidence that the COMI is still in the original country.

V. IS THERE A CASE FOR HARMONIZATION OF E.U. BANKRUPTCY LAW?

The developments discussed in the preceding pages prompt the question as to whether the E.U. mechanism of choice-of-law and choice-of-forum in insolvency law needs to be amended and, ultimately, if bankruptcy law should be harmonized or unified at continental level. After all, a number of similarities emerge nowadays between the E.U. and the U.S., since European corporations have an increasingly continental dimension and can reincorporate into another member state without the need to liquidate⁷⁵. A complete "centralization" of bankruptcy law, therefore, might seem a straightforward conclusion and a desirable goal.

In contrast to the U.S., however, in the E.U. there is no system of federal courts, so that the domestic courts of member states will always govern insolvencies. Thus, disparities of interpretation and the qualities of judgments – as well as courts' differing efficiencies – will always be a part of the E.U. landscape in the field of cross-border insolvencies. Even assuming that E.U. bodies (the Commission, the Council and the European parliament) are empowered to directly enact applicable regulation in the field of insolvency law, instead of mere harmonizing directives that would need to be implemented by each member state, any harmonization or

⁷⁵ The main difference, in this respect, is the permanence in a number of member states of the EU of the Real Seat Theory, so that corporations that want to move to their jurisdiction should also physically transfer there their headquarter.

unification of insolvency rules will be partial, due to the existence of a many competent venues.

In the following pages, I will address the policy alternatives faced by E.U. bodies. To better understand this issue it is important to sort out the advantages and disadvantages of the three main policy options discussed above, namely decentralized model with mandatory choice-of-law and forum criterion, choice model and centralization.

A. Decentralization with mandatory choice-of-law and choice-of-forum criteria

1. Advantages

According to decentralized models with mandatory choice-of-law and forum criteria, as we have seen above, one single member state is competent to govern each bankruptcy and its competence is established according to a uniform criterion for all member states, such as the COMI under the Insolvency Regulation. The goal and main advantage of mandatory choice-of-law and choice-of-forum criteria, coupled with the universality principle as to the reach of court's powers, is to enhance legal predictability and avoid regulatory arbitrages at the expenses of creditors. Additionally, the universality principle has following advantages, as compared with territoriality: (a) it is easier to recover the firm; (b) creditors are treated equally; (c) creditors need to file in just one member state⁷⁶.

⁷⁶ See: Westbrook, *Theory and pragmatism*, *supra* note 17, 464 - 471; Lucian Arye Bebchuk & Andrew T. Guzman, *An Economic Analysis of Transnational Bankruptcies*, 42 J.L. & ECON. 775 (1999).

2. Disadvantages

This model, however, has its disadvantages, the most significant being the risk that the debtor will manipulate the COMI and, in this way, will shop for the preferred law and bankruptcy venue in a murky way⁷⁷. As we have seen, these manipulations are possible because the COMI is a factual criterion and, consequently, a corporation, by shifting their assets, their activities or their headquarters, can shift also its COMI, if it gives evidence that the real COMI location was recognizable by third parties.

Of course, in the European Union this transfer of headquarters from one state to another is neither easy nor inexpensive, because the debtor needs to shift a significant portion of its business and activities in order to comply with ECJ's case law requiring that the transfer is recognizable by third parties. However, the criterion that the location of the COMI (and therefore its transfer) should be recognizable by third parties has a significant weakness. In the case of transfer of the COMI from one state to another, such requisite protects only potential creditors who enter into a contractual relation with the corporation after the transfer of the COMI and are aware of the new "home country" of their debtor. In contrast, preexisting creditors, who entered into a contractual relation with the corporation before the transfer of the COMI, are not protected at all. This produces relevant economic consequences. *Ex ante*, potential creditors can never be sure

⁷⁷ See: Gabriel Moss & Christoph Paulus, *The European Insolvency Regulation - The Case For Urgent Reform*, 19 INSOLVENCY INTELLIGENCE, 1, 3 (2006); Mc Cormack, *Jurisdictional Competition*, *supra* note 60, 191.

that their debtor will not transfer headquarters abroad or will not try to enter into transaction that will lead to a midstream transfer of the COMI. This risk of opportunistic behaviors of the debtor will ultimately raise the agency costs of credit.

B. *Choice model*

1. *Advantages*

Decentralization can be coupled with free choice of bankruptcy law, instead of mandatory choice-of-law and choice-of-forum criteria.

The choice model has some advantages. Under the “demand side” of bankruptcy law, corporations can avoid inefficient regulations enacted by the home country⁷⁸.

Bankruptcy law is a highly "political" matter and policy-makers might be cemented to past decisions due to the high political costs produced by any amendment of the law. Indeed, as we have seen, insolvency law has redistributive effects among corporate stakeholders and amending such law affects the outcome of such redistribution. Whatever amendment of past rules would change the past redistributions and social equilibriums; consequently, its political payoff for

⁷⁸ On the efficiency of legal plurality see: Roger van den Bergh, *Subsidiarity as an Economic Demarcation Principle and the Emergence of European Private Law*, 5 MAASTRICHT JOURNAL OF EUROPEAN LAW, 129, 140 (1998).

policy-makers could be negative, while the political payoff of no amendment is often zero⁷⁹.

Indeed, in the European Union, there are some cases of regulatory arbitrages that have given to distressed corporations the opportunity to enter in workout plans that would not be allowed under the law of the original "home state"⁸⁰.

2. Disadvantages

The choice model, however, bears some significant risks. The first risk is to reduce legal predictability *ex ante*. In order to avoid this, the option for a certain insolvency law should be made in the Articles of Association, so that the creditors, by knowing this information, can discount the "value" of the applicable bankruptcy law from the cost and the conditions of credit. Additionally, the mechanism to change applicable bankruptcy law should somehow protect preexisting creditors.

Adjusting creditors can protect themselves against the risk of a moral hazard of their debtor by adjusting the credit rate or by adopting proper contractual provision, such as an acceleration of the debt in case of transfer of COMI from the

⁷⁹ However, if exogenous shocks shift the economic relations among interests groups, the inactivity becomes politically more costly and politicians are induced to amend the current law.

⁸⁰ See: Wolf-Georg Ringe, *Forum shopping under the EU insolvency regulation*, EUROPEAN BUSINESS ORGANIZATION REVIEW, 579, 585 – 586 (2009): in both cases, German companies managed to convert into English ones (and succeeded in the aim to avoid the prohibition of cross-border conversion of German law) in order to enter into a debt-equity swap under English law and to apply English insolvency law that facilitate the approval of workout plans by creditors.

original state to another⁸¹. Consequently, only non-adjusting creditors, for instance employees or small suppliers, will carry the risk of COMI transfer⁸². For them, it is important which bankruptcy law will apply, as this will influence their payout in case of default. In other words, any choice of bankruptcy law risk to increase the agency cost of credit for non-adjusting creditors.

Furthermore, free choice of bankruptcy law will displace a member state's power to protect "weak" local interests. Under the viewpoint of the policy-makers, a choice model is not compatible with "redistributive" bankruptcy law provisions whatsoever, since debtors' right to choose the preferred law would displace the power of the state to effectively regulate such issues.

C. Centralized systems

1. Advantages

The last option is full centralization or harmonization of bankruptcy law. The most significant advantage of this model is to properly address the continental dimension of European firms and the increased market integration in the E.U. Identical rules would apply throughout the European Union, independently from assets' or creditors' locations or from the company's registered office. Regulatory arbitrages and forum shopping at the expenses of creditors would be banned and

⁸¹ See: Enriques & Gelter, *Regulatory Competition*, *supra* note 58, 432 – 433, regarding reincorporations abroad.

⁸² For a more complex taxonomy see Guzman, *International Bankruptcies*, *supra* note 17, distinguishing "weak-nonadjusting creditors", who pool different debtors together and apply to all them the same interest rate, and "strongly nonadjusting creditors", who are not able to discount the value of the applicable law at all.

all creditors, both adjusting and non-adjusting ones, would know in advance and with certainty which rules would apply in case of default of their debtor. This would reduce the transaction costs associated with corporate activities and increase the overall efficiency.

In addition, full centralization would be a remedy against negative externalities produced by domestic legislations of member states. Indeed, under the current decentralized model of Insolvency Regulation a single member state is competent to regulate the insolvency, even though its effects are borne by citizens of other states. If a significant amount of activities or creditors are located in other countries, insolvency regulations can create negative externalities and “spillover effects”⁸³. A complete centralization would prevent such spillover effects, because the highest possible authority, corresponding to the continental dimension of a debtors' activities, would regulate the debtors' default and, in this way, “internalize” all negative externalities.

Finally, a fully centralized model would regulate the separation of corporate law and insolvency law in a very simple and predictable fashion, namely by institutionalizing such separation. Under the present model, if the debtor gives evidence that the COMI diverges from the registered office, or if a court of another state “moves first” under the priority principle, bankruptcy law of a state different from the state of incorporation would apply, despite the strong correlations between these two sets of rules. This outcome is unpredictable and creditors bear the risk that corporate and bankruptcy laws are detached from each other if the

⁸³ See above page 13.

debtor goes bust. A full centralization would avoid this risk by establishing a permanent division between corporate and bankruptcy law, similarly to the U.S. model. In this way, creditors would take into account *ex ante* this division and will discount the value of the combined effect of E.U.-wide uniform insolvency law and of corporate law of the state of incorporation.

2. Disadvantages (in the E.U.)

After a more searching analysis, however, this optimistic view of centralization does not seem to be consistent, at least under the present structure of European powers and legislative mechanisms. The main difficulty is related to the E.U. policy-making procedure. Any harmonizing act of the E.U. should be adopted following the ordinary legislative procedure⁸⁴ that is aimed at mediating between the Commission - which also has the power to submit the proposal - the Council and the European Parliament. This procedure, in other words, diverges from the legislative procedures of member states that are based upon majority votes within their national Parliaments. The ordinary procedure of E.U. legislation is much more complicated than national legislative proceedings and is often opaque and lacks of an adequate accountability, because it involves mediations between states. Consequently, I would doubt that E.U. legislation is appropriate to embody "redistributive" bankruptcy rules. Such rules, as we have seen above, are a product of specific political equilibriums among social forces within a given

⁸⁴ Art. 294 TFUE.

society and, at the present stage of the E.U. development, political societies and political institutions are not yet unified.

Additionally, a uniform E.U. bankruptcy law risks to protect strong interest groups, which have the ability to bargain at the highest level⁸⁵ and, therefore, can obtain the enactment of rules that protect them in a much more stable way than at member state level⁸⁶. Local interest groups, by contrast, do not have this power, unless they manage to build coalitions. As we have seen, a similar dynamic has produced the unification of U.S. bankruptcy law at the end of the 19th Century and one can predict that, if creditors' interests will be sufficiently homogeneous throughout the EU, creditors will require uniform rules. Presently, however, only banks and institutional investors have sufficient influence to bargain at E.U. level. A uniform bankruptcy law, therefore, risks at being excessively "pro - banks" and neglecting the interests of other corporate stakeholders.

D. Conclusions: the case for partial harmonization and for transparent forum and law shopping

In the former sub-sections, I have discussed the advantages and disadvantages of the three main options: decentralized model with a mandatory choice-of-law and forum criterion, free choice of law and centralization of bankruptcy law. None of the aforementioned "pure" mechanisms is perfect and all of them present

⁸⁵ Macey, *Federal Deference*, *supra* note 24, 271.

⁸⁶ William J. Carney, *The Political Economy of Competition for Corporate Charters*, 26 J. LEGAL STUD. 303, 310 (1997).

advantages and disadvantages that need to be weighted. In particular, (a) decentralized models with mandatory choice-of-law and forum criteria do not place sufficient barriers against opportunistic forum shopping and regulatory arbitrages; (b) free choice of law might produce efficient regulatory arbitrages and induce states to engage in regulatory competition, but it also erodes states' power to pursue their own policies and redistributive goals in favor of domestic weak constituencies and risks to increase agency costs for non-adjusting creditors; (c) centralization or harmonization of bankruptcy law can properly address spillover effects and legal uncertainties, but at the same time this does not seem to be appropriate at the present stage of development of E.U. institutions and cannot be entirely pursued due to the lack of federal courts in the E.U.

A compromised solution, however, is to accept and regulate regulatory arbitrages in a transparent way. Indeed, as we have seen above, the current modified universalism of the Insolvency Regulation has a number of flaws, the most significant of which is its claim to have made the applicable law predictable and to have banned forum shopping. In fact, the reality is that corporations often move across the E.U. and "shop" - or try to shop - for the best law. It is, therefore, much more transparent to govern regulatory arbitrages and forum shopping instead of denying their existence.

In order to reach this goal, at least one specific issue should be harmonized, namely the initial moment of the insolvency, since different member states often

disagree upon the concept of "insolvency"⁸⁷ and upon the proper proceeding that triggers the priority over other member states' courts. These disharmonies have caused significant distortions in the regulatory competition, due also to the "priority principle" (that was conceived in a much more "static" world). The harmonizing measure, therefore, should put in clear words that the priority principle is not triggered by provisional proceedings, such as the appointment of a provisional administrator, without sufficient evidence of the location of the COMI.

With the aim to create a transparent mechanism for regulatory arbitrages it has been persuasively proposed to replace the COMI criterion with the registered office as choice of law mechanism⁸⁸. Consequently, a corporation that transfers abroad its registered office would shift also its applicable bankruptcy law and jurisdiction. To avoid the risk of opportunistic law and forum shopping at the expenses of creditors, the right to obtain advanced payment or a guarantee⁸⁹ - similarly to the legislations on cross-border mergers or cross-border conversions⁹⁰ - should protect creditors.

As we have seen above, however, choice models displace member states' powers to enact "politically sensitive" rules to protect weak local interests. If a

⁸⁷ See also Insol Report 9 – 12.

⁸⁸ See: Armour, *Who Should Make Corporate Law?*, *supra* note 52, 407 – 408; Ringe, *Forum shopping*, *supra* note 80, 615; Marek Szydło, *Prevention of Forum Shopping in European Insolvency Law*, EUROPEAN BUSINESS ORGANIZATION REVIEW, 253, 270 – 271 (2010).

⁸⁹ See: Horst Eidenmüller, *Abuse of Law in European Insolvency Law*, EUROPEAN COMPANY FINANCIAL REVIEW, 1, 13 (2009) (even without any legal innovation, if the COMI is transferred with the registered office the domestic mechanisms for creditor protection apply).

⁹⁰ See: Cross-border Mergers Directive article 4 §2, requiring member states to provide some kind of creditors protection against cross-border mergers. For an overview see: Federico M. Mucciarelli, *Freedom of Reincorporation and the Scope of Corporate Law in the U.S. and the E.U.*, NEW YORK UNIVERSITY LAW AND ECONOMICS WORKING PAPER No 257, 55 – 57 (2011).

corporation could freely opt for the preferred bankruptcy law and venue, without any link to the place where their creditors are, the member state where creditors and employees are located will not govern this insolvency. Adjusting creditors will discount the value of the applicable law from the interest rate or will protect themselves with adequate covenants, but non-adjusting creditors will not.

In order to keep the advantages of the optional model and, at the same time, to allow member states to protect local non-adjusting creditors, a solution is to split "bankruptcy law" into two separate segments. On the one hand, there is general bankruptcy law, encompassing, among others, all procedural rules, trustees' powers, directors' liabilities and rules on the establishment of insolvency estate. These issues should be governed by the state of the registered office. From these rules, however, we can distinguish "redistributive" issues, such as the pecking order, claims' priorities and the prerequisites of claw-back actions, which should be regulated by the law of the state of the center of the main interests. In this regard, we can also consider canceling the presumption that the COMI coincides with the registered office, although this option risks to increase conflicts of jurisdiction.

Under this model, therefore, if the COMI diverges from the registered office, the competent court is required to apply, together with domestic general insolvency rules, other member states' rules. One might worry that the extensive application of foreign laws by national courts would not be a realistic task for domestic judges of member states, due to cultural differences and to the inability to understand a foreign language and legal environment. This rather pessimistic view, however,

would be an obstacle to any further development of the European integration. On the contrary, the process of European integration requires member states courts to consider the application of the law of other member states as a part of their everyday job, rather than as an exception.